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PRZEMYSŁAW PANFIL*

FISCAL RULES AND FISCAL ILLUSIONS – THE EXPERIENCE OF POLAND[1]

Abstract

The aim of this article is to provide the synthetic presentation of over twenty years of Poland's experience in establishing and obeying the system of fiscal rules. This experience depicts the scale of problems entailed by public authorities' low determination as regards observance of constraints imposed on them. Therefore, it is necessary to substantially reinforce the budgetary frameworks in Poland with the use of the best European models. Firstly, the ESA 2010 standards should be fully implemented into the Polish legal order. Secondly, the Polish system of fiscal rules should be complemented with the budget balance rule, which would make it easier to achieve and maintain a medium-term budgetary objective defined by the EU regulations. Thirdly, a fiscal institution should be established, which would allow for constant and independent of the government monitoring of the observance of fiscal rules. Such institutional changes would make it possible to constrain the discretionary nature of the fiscal policy and, consequently, would increase Poland's fiscal sustainability in the medium and long term. The basic research methods used in this paper are dogmatic analysis and comparative legal analysis.

Key words: deficit bias, public debt, fiscal sustainability, fiscal rules, fiscal illusions.

JEL Classification: H6

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* PhD, assistant professor at the Department of Financial Law at the Faculty of Law and Administration of the University of Gdańsk. An academic teacher since 2004. Author of over 100 publications in the field of financial law, including budgetary law, tax law and public banking law. Contact e-mail: przemyslaw.panfil@ug.edu.pl; ORCID: https://orcid.org/0000-0003-3717-4664.

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1. Introduction

In 2010-2012, the Euro area experienced a debt crisis, which was a serious challenge for the process of monetary integration. However, there is no doubt that it has contributed to better understanding of the essence of fiscal sustainability, as well as complex interactions between modern countries and other financial market participants. Moreover, the debt crisis resulted in significant regulatory changes in the legal and institutional order of the European Union [hereinafter referred to as the EU]. On the one hand, these changes were to reinforce the coordination of the Member States' fiscal policies. On the other hand, the implemented regulations were to make it easier to restore fiscal sustainability in countries struggling with the crisis.

The actions undertaken by the European legislator became a catalyst to a number of national changes, which resulted in reinforcement of budgetary frameworks in the majority of the EU Member States. This is proved by a clear improvement of the Fiscal Rule Index calculated by the European Commission, which has been observed since the debt crisis. The above-mentioned processes have also covered Poland, although this country seems to be beyond the mainstream of institutional changes taking place in the EU Member States. The main reason for this should be searched for in the lack of sufficient political support for further reinforcement of constraints imposed on fiscal authorities as regards the policy conducted by them. This problem is manifested in adjusting the form of fiscal rules to the current budgetary situation and evading constraints implied by these rules by way of creating fiscal illusions.

The aim of this article is to provide a synthetic presentation of over twenty years of Poland's experience in establishing and obeying the system of fiscal rules. This experience depicts the scale of problems entailed by public authorities' low determination as regards observance of constraints imposed on them. It also emphasises the importance of well-structured institutional arrangements constituting a part of the broadly defined budgetary frameworks.

The article consists of five parts. The first theoretical one presents the causes of deficit bias and risks generated by this phenomenon as regards fiscal sustainability. The second part describes the essence and desirable features of fiscal rules, which are to protect fiscal sustainability. The considerations included in this part are also primarily of theoretical nature. The third section presents the structure of the Polish fiscal rules applying to the public finance sector, as well as the key changes of these rules in the past. The following part of the article provides a description of mechanisms used by the Polish public authorities to evade the constraints implied by fiscal rules. The final section, on the other hand, makes an attempt at evaluating the solutions applied in Poland and suggests legislative changes referring to the models used by other EU Member States.

2. Deficit bias and fiscal sustainability

Before World War II, one of the unwritten rules of fiscal policy was the need to balance the budget [Buchanan 1997]. This approach, however, began to change under the influence of the Keynesian Revolution. It gave theoretical foundation for discretionary management of aggregate demand in the economy and changed the perception of public finance functions. Nevertheless, the way of conducting fiscal policies has not changed substantially since the early 1970s. A factor stabilising public finance was the Bretton Woods system of monetary management, in which the participants could not allow chronic budget deficits [Laidler 1985]. The final discontinuation of this system and the outbreak of the first oil crisis in 1973 marked the beginning of the period of rapid public debt accumulation. Consequently, deficit bias became apparent among contemporary democracies. The source literature distinguishes several interrelated causes of deficit bias. They include: 1] information asymmetry between the people responsible for fiscal policy and the voters [Calmfors, Wren-Lewis 2011], 2] dynamic time preference inconsistency among contemporary consumers [Krogstrup Wyplosz 2007], 3] the common pool problem, when the current and future public income becomes an over-exploited common resource, and 4] inter-period allocation of funds, as part of which the living generation offloads expenditures to future generations [Alesina, Perotti 1994].

Deficit bias is becoming a serious threat to fiscal sustainability. When approached from a traditional perspective, this notion is understood as the ability to continue a given fiscal policy with no interperiodic budgetary constraints being violated [Mackiewicz 2010]. In other words, a fiscal policy is sustainable when the expected current value of future primary surpluses is equal to the initial debt value [Bohn 2005]. This approach matches the concept of the so-called long-term debt stabilisation. It is defined as a situation in which fiscal authorities are able to continue debt service with no need to make unrealistically substantial adjustments of future budget balances [IMF 2002].

The above-mentioned and very simple approach to fiscal sustainability has changed significantly because of the experience gained during the global financial crisis and the debt crisis in the Euro area. Increasing importance has been attached to tasks which should be covered by public finance. In particular, attention has been paid to the enormous costs of stabilisation activities undertaken both with regard to the financial sector and selected sectors of the real economy. As a consequence, fiscal sustainability has been defined as the government's ability to maintain a reliable and usable level of public finance over a longer period of time. This requires public authorities to become involved in the process of maximising future revenues and fulfilling obligations, taking into account environmental factors, as well as social and economic trends [OECD 2013]. Therefore, sustainability means avoiding an excessive increase in government liabilities, which will become a burden on future generations, while ensuring that the government is able to deliver the necessary public services, including the necessary safety net in times of hardship, and to adjust its policy in response to new challenges [European Commission 2012].

3. Numerical fiscal rules as fiscal sustainability defence instruments

In the 1980s, a number of countries experiencing increasing fiscal imbalance began to introduce medium-term fiscal adjustment plans. In the majority of cases, however, they did not bring satisfactory results [Kopits, Symansky 1998]. The magnitude of the increasing problem was additionally emphasised by another wave of the debt crisis, which convulsed the economies of many developing countries in the 1980s [Reinhart, Rogoff 2010]. This was also when the so-called monetary revolution began. This revolution was founded on the experience gained in the period of the 1970s stagflation and conclusions drawn from the rational expectations theory. They suggested that a number of countries were experiencing the phenomenon of inflation bias, which resulted from the lack of monetary authorities' credibility in the eyes of the private sector [Cukierman, Gerlach 2003]. Simultaneously, numerous theoretical papers were written to support the idea of the central bank's independence and to indicate the superiority of a rule-based policy over a discretionary policy [Kydland, Prescott 1977; Barro, Gordon 1983]. Over time, these views began to influence the legislative solutions applied, contributing to an increase in monetary authorities' credibility and effectiveness. At the same time, there were attempts at making use of this positive experience with regard to fiscal policies. In addition, two different types of actions aimed at increasing the credibility of fiscal policy can be distinguished. The first group comprises actions meant to limit the powers of a government or the minister of finance and to transfer them to an independent and specialist public institution. Excellent examples of this approach were the changes in the institutional basis for the public debt management.

The second group of actions aimed at increasing the fiscal policy credibility comprises attempts at defining clear boundary conditions for fiscal policy. The key instruments in achieving this objective are numerical fiscal rules, which are a form of self-limitation for public authorities [Poterba 1996]. Such rules have been known since the 19th century, but in the beginning they were used by Länder, as well as states and cantons comprising federal states [Kopits 2001]. Nationally, they were used for the first time only after the end of World War II in countries such as Germany, Italy, Japan and the Netherlands. However, the fiscal rules implemented by these countries were not supposed to counteract deficit bias. They rather formed an element of more extensive reforms aimed at stabilising the monetary situation in these countries [Debrun et al. 2008]. Similarly, fiscal rules began to be used on a wider scale in the 1990s. In the case of the EU, a certain stimulus to a wider use of this instrument was also Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States. Pursuant to this Directive, all the EU Member States were obliged to introduce numerical fiscal rules into their legal orders.

Numerical fiscal rules can be defined as a permanent constraint on fiscal policy, typically determined in terms of an indicator of overall fiscal performance [Kopits, Symansky 1998]. Depending on the type of the indicator constrained, the following rules can be distinguished: debt, budget balance, expenditure and revenue rules [Schaechter et al. 2012]. If they are introduced by way of legal acts, they constitute substantive laws at the same time, which define the permissible conduct of their addressees. Apart from numerical rules, the source literature distinguishes qualitative rules, which determine the frameworks for making political decisions regarding economy [Milesi-Ferretti 1996]. They are formed, among others, by regulations determining the way of public expenditure allocation and the form of budgetary procedures. In this context, fiscal rules are complements and not substitutes [Ayuso-i-Casals et al. 2009].

The empirical research based on the analysis of statistical data proves that there is a positive correlation between the introduction of numerical fiscal rules and the fiscal results achieved by a given country. However, these results should be approached cautiously, as there is a potential risk of endogeneity [Heinemann et al. 2018], i.e. causal feedback between the response variable and the explanatory variable in a given model [Rommerskirchen 2015]. On the one hand, a significant improvement of fiscal results may become the main motivation to introduce fiscal rules [Poterba 1994], as, over a short period of time, complying with the constraints implied by them is not perceived as a challenge for the entity conducting fiscal policy. On the other hand, fiscal rules can be introduced with securing the results of the public finance reform conducted beforehand in mind [IMF 2009]. In both cases, fiscal sustainability improves before imposing restrictions on decision makers. It is also possible that there are other factors, which were not analysed, and which at the same time influence fiscal results and introduction of fiscal rules. Good examples of them are preferences of voters.

The difficulties with creating statistical models for assessing the effectiveness of fiscal rules resulted in undertaking theoretical works focusing on the structure of these rules. They were aimed at defining the conditions to be satisfied in order to increase the chances of achieving the set objectives by way of implementing specific solutions. Consequently, a certain catalogue was compiled, which specified the features characterising effective fiscal rules. Some of these features are in fact obvious and typical of well-structured institutional arrangements. Fiscal rules should be precisely defined, coherent and appropriate for the objectives set for them. It would be perfect if the implemented solutions were as simple as possible. This makes it easier to present to the society the motives behind the decisions made and win social support for the policy conducted by fiscal authorities. Moreover, simplicity makes it easier to monitor and control the level of compliance with the constraints implied by the rules during budget implementation [Kopits 2001].

One of the key conditions for the effectiveness of fiscal rules is the legal weight of the regulations introducing them. It determines the durability of the adopted solutions, and, thereby, their credibility. In order for fiscal rules to achieve the goals established for them, they cannot be freely modified by the entity subject to constraints implied by the rules. Otherwise, their effectiveness will be illusory and dependent on external factors [Alesina, Perotti 1994]. Traditionally, constitutionally regulated fiscal rules are considered to be the most effective ones. A high level of credibility is also assigned to solutions established supranationally or statutorily.

Fiscal rules should also be as wide in their scope as possible, both in terms of subjective and objective scope. Equally important is the flexibility of the adopted solutions, which should adjust to the current economic situation and be anti-cyclical in their use. At the same time, fiscal rules should not be in conflict with the performance of the stabilisation function of public finance. In times of economic downturn, a budget deficit should be a permissible instrument of fiscal policy used for temporary financing of increased expenditure. From the legal point of view, there are two different options of conferring the desired flexibility upon fiscal rules. On the one hand, this flexibility can result from the very structure of the solution adopted. The best examples here are fiscal rules related to cyclical deficit or structural balance. On the other hand, flexibility can be achieved through the so-called escape clauses. They allow for temporarily lifting the constraints implied by fiscal rules in connection with the occurrence of particular circumstances having a serious impact on a given country's budget situation. It is also justified to create such solutions, which would ensure the binding force of fiscal rules at the time of preparing, passing and implementing the budget. These rules should be valid ex ante and ex post [Inman 1996]. This can be achieved by way of creating an automatic correction mechanism. It can come into effect both after exceeding the fiscal indicator's reference value and in order to prevent this value from being exceeded [Schaechter et al. 2012].

In practice, it is not always necessary or even possible to satisfy all the above-mentioned conditions regarding the structure of fiscal rules. What is more, some of these conditions compete against one another. This problem arises in the case of flexibility and simplicity [Wyplosz 2013]. Because of referring to cyclically-adjusted indicators and using escape clauses, the implemented regulations are becoming increasingly complex and difficult to monitor.

The effectiveness of fiscal rules does not depend on their structure only, but also on the existence of a strong political capital supporting the enforcement of constraints implied by these rules and/ or the high costs of evading them. The said costs can become apparent, among others, through the actions of third-party authorities or strong reactions of the financial market participants [Debrun, Kumar 2007]. Violation of constraints implied by fiscal rules should entail specific sanctions, which may be of financial, legal or image nature [Kopits, Symansky 1998].

Furthermore, great significance should be attributed to institutional arrangements, which define the budgetary frameworks of a given country along with fiscal rules. What should be mentioned here are the adopted accounting and statistical reporting systems, as well as the rules defining the forecasting methods used for the purposes of budget planning. The above-mentioned systems should ensure the public nature and transparency of financial operations executed by the public finance sector units. They make it easier to monitor the observance of constraints implied by fiscal rules and to early indicate the need to modify the policy conducted. On the other hand, reliable forecasts for fiscal and macroeconomic indicators are essential for achieving the goals established for fiscal rules. For over twenty years now, a clear trend to transfer the powers in this regard to independent fiscal institutions has been observed [Panfil 2016]. In a number of countries, such institutions are also entrusted with other tasks, including monitoring of fiscal rules observance, assessment of long-term fiscal sustainability, estimation of costs of new political initiatives and provision of recommendations on the method of conducting fiscal policy [Debrun, Kinda 2014; Calmfors, Wren-Lewis 2011].

Here, it is also worth mentioning the fiscal rule indices, which can be recognised as a synthetic measure of fiscal rule restrictiveness [strength]. This restrictiveness should, at least theoretically, translate into the effectiveness of solutions adopted by a given country. As generally assumed, the structure of these indices consists in attributing scores to various features of the rules [as well as other elements of the broadly defined budgetary frameworks]. The constituent scores are summed up using a special weight system. The aggregate value achieved defines the value of the index.

The best known European index seems to be the Fiscal Rule Strength Index [hereinafter referred to as the FRSI]. It was established by the European Commission's Directorate-General for Economic and Financial Affairs. The methodology of the FRSI calculation was based on the works of Deroos et al. [2006] and Sutherland et al. [2006]. In 2015, the index underwent certain changes, and since that time the following eight factors have been taken into account when assessing a given fiscal rule: 1] statutory/legal base of the rule, 2] room for setting or revising objectives; 3] nature of the body in charge of rule monitoring; 4] real-time monitoring; 5] nature of the body in charge of monitoring the correction mechanism in case of deviation from the rule; 6] independent body providing/endorsing macro/budgetary forecasts; 7] correction mechanisms in case of deviation from the rule; 8] resilience to shocks or events outside the control of the government.

4. Polish numerical fiscal rules

Similarly to all other EU Member States, Poland is subject to three supranational fiscal rules under the EU law. Two of these rules, i.e. deficit and debt reduction in the general government sector, are regulated in the Treaty on the Functioning of the European Union. The third rule, reducing medium-term expenditure growth, is provided for in the amended Council Regulation (EC) No 1466/1997 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies. Unfortunately, from the viewpoint of the effectiveness of the above-mentioned solutions, it is of great importance that Poland has not adopted the common currency. As a matter of fact, the EU law provides for a system of sanctions for disciplining countries which ignore supranational fiscal rules. However, the majority of these sanctions, including interest-free deposits and fines, can be applied with regard to the members of the uniform currency area only. From this point of view, in the case of countries which have not adopted the common currency, nationally established rules grow in importance.

The first Polish fiscal rule was provided for in Art. 216, paragraph 5 of the Constitution of the Republic of Poland of 2nd April 1997 [hereinafter referred to as the Constitution]. This provision provides for a ban on contracting loans or providing guarantees and financial sureties which would engender the public debt exceeding three-fifths of the value of the annual gross domestic product [hereinafter referred to as GDP]. This solution, which was adopted before Poland's accession to the EU, was a form of the national legal order adopting an EU debt rule. Nevertheless, both fiscal rules, i.e. the Polish one and the EU one, are not identical. This results from the fact of Poland applying its own budget accounting system, which slightly differs from the regulations provided in the European System of Accounts [hereinafter referred to as ESA2010]. The scope of public debt calculated based on the Polish method is narrower than in the case of debt in the general government sector. This refers, in particular, to the subject party. As a consequence, the Polish debt rule covers around 97.5% liabilities of units in the general government sector.

Undoubtedly, an enormous advantage of the Polish debt rule is its durability resulting directly from its constitutional legal basis. Simultaneously, the government, which is the main addressee of the constraints implied by this rule, has no direct influence on their form. However, it should be pointed out that Polish debt rule is not suitable for operational use, as it by no means defines the notion of "public debt" or "GDP". However, it recognises the way of calculating these indices as a statutory matter. Consequently, it is the Polish legislator that eventually defines the constitutional debt limit. This gives the government an indirect opportunity to influence the fiscal rule under discussion. Based on parliamentary majority, this body can initiate legislative changes, which, by way of modifying the method of calculating the public debt or GDP, shall reduce the constraints implied by the Constitution.

The constitutional debt limit is characterised by a high level of simplicity and it is comprehensible to a wider public. Unfortunately, this rule in no way takes account of the country's economic situation and it is of pro-cyclical nature, as, on the one hand, it does not provide any incentives to undertake necessary reforms in the so-called good times. On the other hand, it is a serious challenge for performance of the stabilisation function of public finance in the period of economic slowdown. It should be highlighted here that the case of public debt exceeding 60% GDP would be equal to violating a constitutional standard. This would denote the need to immediately undertake actions aimed at restoring the state compliant with the Constitution. On the other hand, cutting expenditure and/ or raising taxes in the period of economic slowdown would result in further weakening of aggregate demand. Taking into account the above-mentioned risk, the Polish legislator has decided to supplement the constitutional debt limit with a correction mechanism. Currently, it is regulated in Art. 86-88 of the Public Finance Act of 27th August and has the form of the so-called prudence and recovery procedures. These regulations provide for a set of solutions aimed at reducing the volume of debt, reducing or eliminating budget deficit and adopting an appropriate recovery plan. The prudence and recovery procedures define subsequent debt levels, the exceeding of which results in imposing further-reaching constraints on authorities responsible for the fiscal policy. The basic instruments used to achieve this objective are regulations reducing the permissible levels of the national budget deficit and deficits of local government units.

Over the period of twenty years of its functioning, the constitutional debt limit did not directly constrain the conduct of fiscal policy. This resulted mainly from the relatively low level of public debt in Poland. On the other hand, a big challenge was the debt rule correction mechanism. In the beginning, it took account of the sum of public debt and the amount of projected payments due to sureties and guarantees granted by the public finance sector units. At the same time, the correction mechanism defined three thresholds [50, 55 and 60% GDP], the exceeding of which by the above-mentioned total in a year x resulted in imposing constraints on the way of conducting fiscal policy in a year x + 2. The first threshold of the prudence and recovery procedures was exceeded in Poland for the first time in 2003-2004, which should result in constraining the permissible level of budget deficit in 2005-2006. In fact, the constraints were in force in the first of the said years only. Afterwards, the government initiated legislative changes, as a result of which the correction mechanism ceased to take account of the projected payments due to sureties and guarantees granted by the public finance sector units. It is worth emphasising that these payments accounted for exceeding the first threshold of the prudence and recovery procedures in 2004, as public debt as at the end of this year was 48.8% GDP. Thanks to the changes introduced, the government could plan the budget for 2006 without being subject to any constraints regarding the budget deficit level.

The first threshold of the Polish debt rule correction mechanism was again exceeded in 2010, and the ratio of public debt to GDP was higher than 50% GDP till as late as 2013. Nevertheless, the correction mechanism constrained the conduct of fiscal policy in 2012 only. This was because of the Polish legislator, who at first suspended the application of the first threshold of the prudence and recovery procedures and then eliminated regulations governing it from the Polish legal order. As a consequence, since 2013 the correction mechanism of the constitutional fiscal rule has come into effect only upon public debt exceeding the level of 55% GDP.

The catalogue of Polish fiscal rules also includes an expenditure rule. It was introduced on 1 January 2011, when Art. 112a of the Public Finance Act came into force. Pursuant to this provision, the national budget expenditure in a year x + 1 could not exceed the expenditure planned for the year x increased by the forecasted inflation rate and additionally by one percentage point. However, this rule was to be in force only until the moment of the Economic and Financial Affairs Council issuing a decision on repealing the excessive deficit procedure towards Poland. Additionally, its objective scope was rather narrow, and it covered mainly discretionary spending.

Finally, the above-mentioned form of the expenditure rule was valid till the end of 2013, when Art. 112a of the Public Finance Act was repealed and replaced with a new division, Art. 112aa. This modification was to a certain extent forced by the need to adjust the Polish regulations to the requirements set for national fiscal rules by Council Directive 2011/85/EU. The Polish legislator intended this rule to make it easier for Poland to achieve a medium-term budgetary objective of -1% GDP over a longer period of time. For that reason, the rule was relatively wide in its scope, and covered around 90% operations in the general government sector.

The expenditure rule currently applied in Poland is generally assumed to make the growth rate of expenditure of selected institutions and authorities dependent on two basic factors. The first one is medium-term GDP growth. In practice, it is analysed on an eight-year basis, as this is the average length of an economic cycle in Poland. The second factor influencing the permissible level of expenditures was in the beginning the forecasted annual average inflation rate. Thanks to taking it into account, it was possible to realign expenditure growth and adjust it to the growth in prices. However, this solution was modified by way of the Act on Amending the Public Finance Act of 10th December 2015. It was one of the first laws adopted by the new Parliament, and all the modifications provided for in this law were applicable to the new budget act for 2016. The key element of amending the fiscal rule discussed was giving up the realignment of spending limits based on the forecasted annual average inflation rate and replacing it with the inflation target of the National Bank of Poland. The explanatory statement of the bill introducing the above-mentioned modification explained it with excessive variability of the inflation level, which allegedly caused significant uncertainty in the process of budget planning. As a matter of fact, it seems that the main reason for modifying the fiscal rule in 2015 was deflation experienced by Poland in 2015-2016. In 2015, deflation was 0.9%, and 0.6% in 2016. The increase in the value of money caused reduction of the permissible level of spending for 2016, which left no room for implementation of new and very expensive social programmes. It should be highlighted that since 2004 the inflation target of the National Bank of Poland has been 2.5%. Consequently, calculation of spending limits based on this indicator made it possible to partially solve the problem faced by the government willing to fulfil its election promises.

5. Fiscal illusions in Poland

Changes in legislative solutions aimed at relieving the constraints implied by fiscal rules are perceived disapprovingly by the financial market participants, as they prove the lack of government determination to undertake necessary reforms. Over time, this may lead to lower ratings of a given country and growth of the risk premium demanded by the buyers of treasury securities. In such a case, side effects of modifying fiscal rules are higher costs of debt service. Moreover, such modifications can be treated by a society as a form of a government recognising its failure, and they may influence voters' preferences. Consequently, direct influence on the form of fiscal rules is connected with a certain risk, which is difficult to be explicitly identified. Because of that, a government, which is officially subject to constraints implied by these rules, sometimes undertakes steps aimed at evading them. In that manner, it knowingly generates fiscal illusions, creating in a society a false picture of its actions and the condition of public finance.

The most obvious way of evading Polish fiscal rules results from a peculiar coincidence of three circumstances. Firstly, one of the factors influencing the constraints implied by the expenditure rule and the correction mechanism of the constitutional limit is the forecasted level of GDP. Secondly, preparation of macroeconomic forecasts necessary for a budget bill is among the statutory powers of the Minister of Finance. What is important, there are no instruments, which would allow, from a legal point of view, to verify the viability of these forecasts and, consequently, the viability of budget assumptions. Thanks to this, the Minister of Finance may treat the values adopted while preparing the budget bill instrumentally and adjust them to its needs. Thirdly, the constraints imposed by the correction mechanism of the constitutional debt limit and the expenditure rule are binding only at the stage of preparing and passing the budget bill. There are no mechanisms for verifying the level of achievement of the objective set for the implementation of these rules. These circumstances constitute a peculiar incentive for the Minister of Finance to make “optimistic” forecasts about the level of GDP. The potential liability for any errors committed in this regard is of political nature only and is borne as part of the democratic choice process. However, taking into account the scale of complexity of the subject discussed, any potential manipulations with macroeconomic forecasts are not even perceived by an average voter.

Nevertheless, the greatest threats to the effectiveness of fiscal rules in Poland are modifications of legislative solutions, which do not seem to be associated with these rules, but have an indirect impact on the objective or subjective scope of constraints implied by them. In this case, the motives underlying the legislator's actions are of immense significance. Any attempts at determining them should be based on a comprehensive analysis of the results of implementing new legislative solutions, and not only on becoming acquainted with explanatory statements of acts providing for them. In addition, it cannot be a priori precluded that such an indirect modification of the scope of fiscal rules is only a side effect of the actions undertaken by the legislator with the aim of achieving different objectives. In the case of such an analysis, the circumstances in which the valid legislative solutions are modified grow in importance. From the viewpoint of the government, which usually initiates such modifications, they are justified only if fiscal rules constrain the freedom of fiscal policy or there is a high risk of that they begin to constrain it in the immediate future. Thus, such modifications are introduced in the case of deteriorating condition of public finance. However, there is no justification for modifications of fiscal rules, which may potentially influence the conduct of fiscal policy in an undefined future, when the problem may concern a new government.

Over the last twenty years, the Polish legislator has introduced a number of legislative changes, which made it “easier” for the government to observe the constraints implied by fiscal rules. They most often allowed to reduce budget expenditures and, consequently, the deficit level and the growth dynamics of public debt. A good example is the establishment of the National Road Fund and the Railway Fund [in 2004 and 2006 respectively]. These entities perform the state tasks as regards the development of Polish road and railway infrastructure. What is particularly important, they are outside the public finance sector, which defines the subjective scope of the public debt. Thereby, liabilities of these institutions are not subject to constraints imposed by the constitutional debt limit. Even the fact of them being covered by the State Treasury guarantees is of no importance here. It is also worth highlighting that the scope of the National Road Fund's tasks was substantially extended in 2009. This change was introduced when the public finance situation was deteriorating, which forced new solutions to be searched for in order to reduce the budget deficit growth. There are two other fiscal tricks having the similar constructions to the National Road Fund that were implemented during the coronavirus pandemic. Actions supporting the economy undertaken by the government were financed through the COVID-19 Response Fund and Polish Development Fund. These institutions are also not included into the public finance sector.

Another example of actions undertaken by the Polish legislator, bearing all the features of fiscal illusions, was the reform of the pension scheme carried out in 2014. At that time, Poland was struggling with the problem of rapid growth of national public debt, which was dangerously approaching the constitutional debt limit. As a consequence of legislative changes, some liabilities of open pension funds [operating within the private sector] were transferred to the Social Insurance Institution [which is part of the public finance sector]. Simultaneously, the State Treasury took over from open pension funds the treasury bonds issued in the past and then redeemed them. This made it possible to reduce the national public debt by PLN 130 billion, which amounted to more than 7% GDP. On the other hand, the takeover of additional pension obligations by the Social Insurance Institution shall worsen the performance of this entity in the future and force an increase in the subsidies granted to it from the state budget.

Similarly, the examples of creating fiscal illusions in Poland can be identified over the recent years. Interestingly enough, such actions were undertaken in times of very good economic situation, which translated into quite a good condition of public finance. The Polish government, however, intended to make use of high tax receipts to implement costly social programmes, which were assumed to influence voters' preferences. In this context, there was a significant challenge to face, i.e. the constraints implied by the expenditure rule. Apart from the above-mentioned change in the structure of this rule, it was also necessary to undertake actions aimed at evading it. A good example here is the way of co-financing Polish public institutions of higher education in 2019. Instead of state budget subsidies or subventions, they received treasury securities with a value of nearly PLN 3 billion. Pursuant to the budget accounting rules applicable in Poland, this amount did not influence the level of the budget expenditure and balance, but was directly counted towards the public debt.

6. Polish fiscal rules – conclusions de lege lata and de lege ferenda

The basis for assessment of the Polish fiscal rules can be the values reached by the FRSI. Table 1 presents data regarding the solutions applied in Poland, which are compared to the situation in other EU Member States in 2017. This comparison covers only those fiscal rules which were applicable to at least 90% of the value of operations carried out by the units of the general government sector. At the same time, in cases when there were several rules of the same type in effect in a given country, Table 1 presents only the one which is characterised by the highest FRSI value.

Table 1 makes it possible to compare the Polish fiscal rules with the solutions applied in other EU Member States. This is of great importance, as these countries are subject to the same constraints implied by supranational EU rules. According to Table 1, as far as the general government sector is concerned, the EU Member States follow above all the budget balance rules. Only Poland and Croatia do not apply this solution. The budget balance rules seem to be quite an obvious choice in the context of obligations under the EU law and, in particular, the necessity to achieve a medium-term budgetary objective. Simultaneously, it was these rules that were characterised by the highest strength in the EU. Given the above, the lack of this type of rules seems to be one of the largest flaws of the Polish budgetary frameworks.

Table 1. FRSI values for selected fiscal rules in the EU Member States in 2017

Country	Rule	FRSI
Austria	BBR	8,47
Belgium	BBR	8,47
Bulgaria	BBR	8,20
	DR	6,80
	ER	7,30
Croatia	ER	5,13
Cyprus	BBR	8,47
	DR	7,47
Czech Republic	BBR	7,03
	DR	6,53
Denmark	BBR	8,20
Estonia	BBR	8,47
Finland	BBR	7,13
	DR	1,73
France	BBR	8,47
Germany	BBR	8,20
Greece	BBR	7,43
	DR	4,53
Hungary	BBR	3,83
	DR	6,70
Ireland	BBR	8,47
	DR	7,07
	ER	5,77
Italy	BBR	8,47
	DR	7,97
	ER	6,97
Latvia	BBR	8,97
	DR	4,90
	ER	3,57
Lithuania	BBR	8,60
Luxembourg	BBR	7,97
Malta	BBR	9,23
	DR	8,23
Netherlands	BBR	8,73
	DR	8,23
	ER	5,37
Poland	DR	7,93
	ER	5,27
Portugal	BBR	8,60
	DR	7,10
Romania	BBR	8,70
	DR	8,20
Slovakia	BBR	8,60
	DR	7,60
Slovenia	BBR	8,47
Spain	BBR	8,33
	DR	7,83
Sweden	BBR	6,03
United Kingdom	BBR	3,83
	DR	3,33

Abbreviations: BBR – budget balance rule, DR – debt rule, ER – expenditure rule.

Source: Author's own work, based on: European Commission, 2019.

According to Table 1, the strongest Polish fiscal rule is the constitutional debt limit. In 2017, the FRSI for this rule was 7.93. This made the constitutional debt limit one of the strongest debt rules applied by the EU Member States. The strength of the Polish expenditure rule was much lower. With the FRSI of 5.27, it was one of the weakest rules of this type applicable in the EU Member States. It is also worth highlighting that the FRSI values for both Polish fiscal rules have been stable. All the above-mentioned legislative changes, which led to a specific "softening" of the constraints implied by these rules, did not have an impact on their final assessment. This depicts in some way the unreliability of the fiscal rule indices, in which the assessment criteria naturally need to be of quite general nature.

The high value of the FRSI for the Polish debt rule was primarily the result of high constituent scores for the assessment criteria directly related to its structure. What is meant here is, in particular, the legal basis of the rule [the Constitution], precise definition of the rule's aim in the legal act establishing the rule, and the existence of an automatic and legally defined correction mechanism [prudence and recovery procedures]. The first two criteria were also of key importance for the assessment of the Polish expenditure rule. However, the lower legal weight of its introductory act and no correction mechanism resulted in the lower value of the FRSI. On the other hand, in the case of both Polish fiscal rules one can easily notice material defects as regards institutional arrangements having an impact on the broadly defined monitoring of the observance of these rules. This translated into a relatively low score in the criteria related to these arrangements. In this regard, the establishment of an independent fiscal institution in Poland should be called for. Based on the source literature, such an entity can be defined as a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence government's fiscal policies [Debrun et al., 2013]. It is worth emphasising that Poland is the only EU Member State, which has no fiscal institution. The establishment of such an entity should be accompanied by entrusting it with the widest powers possible. In particular, taking account of the assessment criteria applied in the case of the FRSI, the Polish fiscal institution should monitor in real-time the observance of fiscal rules and the potential application of correction mechanisms. Moreover, it would be fully justified to impose on the fiscal institution an obligation to prepare macroeconomic and budget forecasts, which would be binding at the moment of the government drawing up the budget bill.

Poland should also give up its own budget accounting methodology and fully adopt ESA2010. It is worth emphasising that this system has already been used by the Polish authorities in connection with the reporting obligations towards the EU bodies. Therefore, it is difficult to provide sensible justification for concurrent use of two different accounting standards. Giving up Poland-specific solutions would significantly limit the possibility of creating fiscal illusions in Poland. For example, pursuant to ESA 2010, the National Road Fund and the Railway Fund are recognised as units of the general government sector. Consequently, these entities' expenditures and liabilities influence the balance and debt level in this sector.

7. Summary

Poland's experience related to using fiscal rules indicate poor determination of public authorities to establish a system aimed at safeguarding fiscal sustainability. On the one hand, this is proved by a low level of the Polish legislator's activity as regards adoption of new legislative solutions. Poland is the only EU Member State, which does not have its own fiscal institution, and one out of two countries, which do not apply the budget balance rule. On the other hand, the applicable fiscal rules are often adjusted to the current political needs or evaded with the use of actions bearing all the features of fiscal illusions. In Poland, deficit bias is very clearly noticeable, in particular, in times of good economic situation. This is when the Polish public authorities undertake actions that increase public spending instead of reforming public finance. The consequences of such decisions, in turn, become a serious challenge for Poland's long-term fiscal sustainability.

The situation described above gives rise to the need to substantially reinforce the budgetary frameworks in Poland with the use of the best European models. Thereby, the Polish legislator's actions should focus on three elements. Firstly, the internal budget accounting system should be given up, and the ESA 2010 standards should be in full implemented into the Polish legal order. Secondly, the Polish system of fiscal rules should be complemented with the budget balance rule, which would make it easier to achieve and maintain a medium-term budgetary objective defined by the EU regulations. Thirdly, a fiscal institution should be established, which would allow for constant and independent of the government monitoring of the observance of fiscal rules. Such institutional changes would make it possible to constrain the discretionary nature of the fiscal policy and, consequently, would increase Poland's fiscal sustainability in the medium and long term.

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